

ST 99-4

Tax Type: SALES TAX

Issue: Machinery & Equipment Exemption - Manufacturing

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

GUMBO'S READY-MIX CO.,

Taxpayer

No. 96-ST-0000
IBT: 0000-0000
NTLs: SF-199500000000000-3

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Gary Stutland, Special Assistant Attorney General for the Illinois Department of Revenue; Ms. Iris Miranda-Kirschner Esq. for "Gumbo's Ready-Mix Co."

Synopsis:

This matter comes on for hearing pursuant to taxpayer's timely protest of the Notices of Tax Liability No. SF-199500000000000-3 ("NTLs") dated December 5, 19xx for the audit period of July 1, 1991 through June 30, 1994. Taxpayer objected to the tax assessed on various transactions, including small load charges, purchases of consumable supplies and fixed assets, resale transactions, and inventory withdrawals. The parties reached agreement on all matters except with respect to the tax imposed upon the

purchases of front-end loaders and their replacement parts. The sole issue at hearing, therefore, is whether the taxpayer, a ready-mix manufacturer, is entitled to the Manufacturing Machinery and Equipment Exemption of the Use Tax Act (“M & E exemption”) on its purchases of front-end loaders and their parts which are used to charge the bins of taxpayer’s ready-mix concrete batch plant.

Following the submission of all evidence and a review of the record and briefs filed herein, it is my determination that the purchases of these front-end loaders and its parts are exempt from Use Tax, therefore, the portion of the assessments attributable to these purchases should be cancelled. The remaining portion of the assessments should be affirmed as agreed to by the parties and as outlined in Dept. Group Exhibit No. 2.

Findings of Fact:

1. The Department established its *prima facie* case, inclusive of all jurisdictional elements, by the introduction of two Correction of Returns for the period of July 1, 1991 through June 30, 1994. Dept. Group Ex. No. 1.
2. The parties have reached agreement on all issues except with respect to the Use tax imposed on the purchases of front-end loaders and their replacement parts. The revised figures represent these front-end loader purchases. Dept. Ex. No. 2; Tr. pp. 3-4, 9-11.
3. Taxpayer manufactures ready-mix concrete for retail sale to end users. Tr. pp. 13, 14, 25. Taxpayer charged tax on the sale of ready-mix concrete to third party purchasers during the audit period. Tr. p. 14.

4. Ready-mix concrete is prepared pursuant to a mix design. Tr. p. 42. The component parts of ready-mix concrete are water, sand, cement, crushed rock or gravel, and various add mixtures. Tr. pp. 26-27.
5. These ingredients are not used in the same ratios for every job. Key factors include weather conditions and the specific use of the concrete. Tr. pp. 26, 27.
6. Suppliers deliver raw material to the taxpayer by way of dump trucks. Tr. pp. 46, 47. Taxpayer does not own these trucks. Tr. p. 46. The material is dumped into piles in the taxpayer's yard. Generally it stays in that location until loaded into the batch plant. Tr. pp. 47, 48.
7. Dump trucks cannot be used to charge the bins of the batch plant. Tr. p. 65.
8. The front-end loaders in dispute do not unload or move the coarse aggregate out of the trucks. Tr. pp. 27-34.
9. The batch plant serves the function of ensuring that the requisite components of concrete, which would be the cement, the aggregate, chemicals, and the water are placed into the truck for mixing in their proper proportions. Tr. pp. 24-25, 34-38.
10. The front-end loaders pick up material off of the ground and load the bin of the cement batch plant. Tr. p. 16. Filling these bins or the act of dumping these materials into the bins is referred to in the industry as "charging the bins." Tr. pp. 67-68.
11. The front-end loader is used almost continuously throughout the day to charge the bins of the batch plant. Tr. pp. 26-28.

12. The concrete batch plant has three bins. Tr. p. 54. Each bin is divided into compartments. Tr. p. 28. The sand is loaded into the middle compartment and the rocks are loaded into the compartments on either side. Tr. p. 28.
13. The plant manager or the batch man oversees the control panel that controls the measuring of the ingredients. He sits in front of the control panel in his office approximately 20 or 30 feet from the bins. Tr. p. 58. The control panel may be either computerized or mechanical. Tr. pp. 68, 69. If the control panel is mechanical, the batch man manually sets the gauges according to the mix design. Tr. p. 69. The batch man releases material from the bin in a specified amount according to the mix formula. Tr. pp. 55, 58, 70, 75-76; Taxpayer Ex. Nos. 3 & 16.
14. After leaving the first bin, the material is loaded onto a conveyer belt and transported upwards for approximately 20 or 25 feet where it is dumped into a second bin. The material is then loaded into a weigh batcher which measures it before feeding it onto a short conveyer belt. Tr. pp. 34-37; Taxpayer's Ex. No. 15. The conveyer belt loads the material into the ready-mix truck for mixing. Tr. pp. 34-35.
15. No other equipment is used for charging the bins of the batch plant. Tr. pp. 31-33, 39, 65-66.

Conclusions of Law:

The Department prepared corrected returns for Use Tax liability pursuant to section 4 of the Retailers' Occupation Tax (hereinafter ROT) Act 35 ILCS 120/4. Said section is incorporated by reference in the Use Tax Act via section 12 thereof. 35 ILCS 105/12.

In the case at bar, the taxpayer is challenging the assessment by the Department of Use Tax, penalty and interest on the purchases of front-end loaders and its parts. The taxpayer asserts that the purchases are exempt from Use Tax based upon the manufacturing machinery and equipment exemption as set forth in section 3-5 of the Use Tax Act as follows:

Sec. 3-5. Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act: ... (18) Manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether that sale or lease is made directly by the manufacturer or by some other person, whether the materials used in the process are owned by the manufacturer or some other person, or whether that sale or lease is made apart from or as an incident to the seller's engaging in the service occupation of producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser. 35 **ILCS** 105/3-5.

The statute further provides:

Sec. 3-50. Manufacturing an assembly exemption. The manufacturing and assembling machinery and equipment exemption includes machinery and equipment that replaces machinery and equipment in an existing manufacturing facility as well as machinery and equipment that are for use in an expanded or new manufacturing facility. 35 **ILCS** 105/3-50.

Section 3-50 of the statute defines equipment as “[a]n independent device or tool that is separate from any machinery but that is essential to an integrated manufacturing or assembling process; . . .” 35 **ILCS** 105/3-50; *also* 86 Ill. Admin. Code §130.330 (c)(3). The Department’s regulation, however, clearly provides that “[t]he fact that particular machinery or equipment may be considered essential to the conduct of the business of manufacturing or assembling because its use is required by law or practical necessity does not, of itself, mean that machinery or equipment is used primarily in manufacturing

or assembly.” 86 Ill. Admin. Code § 130.330(d)(2)(1994). Thus, the taxpayer must not only show that a piece of equipment is essential to the manufacturing process, it must prove that it is *primarily* used in this process.

The Illinois Supreme Court has identified and examined three phrases as the “gist” of the M & E exemption: 1) “tangible personal property”; 2) “process of manufacturing or assembling”; and 3) “primarily.” Van’s Material Co. v. Department of Revenue, 131 Ill. 2d 196, 203 (1989). In that same opinion, the court acknowledged that the legislature enacted the M & E exemption to give a tax exemption on capital investment thereby attracting new manufacturing facilities to Illinois and, at the same time, maintain existing facilities within the state. Chicago Tribune Co. v. Johnson, 106 Ill. 2d 63, 72 (1985); Van’s Material Co., 131 Ill. 2d at 215.

It is undisputed that the taxpayer manufactures ready-mix concrete for sale to retail customers and private contractors, thus it is similarly situated to the taxpayer in Van’s Material. In that opinion, the Illinois Supreme Court held that ready mix concrete constitutes tangible personal property, (id. at 203), therefore, the only issue which remains in the present case is whether the front-end loaders were primarily used in the process of manufacturing or assembling.

In the case at bar, the Department disputes that the front-end loader is used in the manufacturing process, rather it contends that “charging” the holding bins, i.e., loading the bins, of the concrete manufacturing plant, otherwise known in the industry as a batch plant, with sand, gravel and the other materials used to manufacture concrete is a pre-production activity, therefore, the purchase of this equipment falls outside the scope of the M & E exemption. Taxpayer maintains, however, that the use of the front-end

loaders to charge the bin constitutes an essential and necessary part of the manufacturing process and accordingly the purchases of the front-end loaders are exempt from Use Tax.

Taxpayer's brief p. 9.

The statute defines manufacturing process in the following manner:

'[M]anufacturing process' shall mean the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. 35 **ILCS** 105/3-50.

In Van Materials, the Court determined that "whenever labor is bestowed upon an article which results in its assuming a new form, possessing new qualities or new combinations, the process of manufacturing has taken place." Van's Material Co., 131 Ill. 2d 20708 *quoting* Dolese & Shepard Co. v. O'Connell, 257 Ill. 43, 45 (1912). The statute specifies that "[t]he manufacturing process commences with the first operation or stage of production in the series and does not end until the completion of the final product in the last operation or stage of production in the series. ..." 35 **ILCS** 105/3-50(1) Accordingly, a determination of the taxability of taxpayer's use of its front-end loaders should turn on whether charging the bin with the front-end loader constitutes the first operation in the series of operations which collectively comprise the manufacturing of ready-mix concrete.

Such an interpretation is supported by the Illinois Supreme Court's analysis in Van's Material, in which the Court states: "The manufacturing process for ready-mix concrete begins when the four component parts, sand, limestone, water and cement, in

specific proportions are loaded into the turning hollow drum mixer on the ready-mix concrete truck. This initial phase is referred to as the charging process. Once the charging process is completed, the second phase, referred to as the mixing process, begins.” *Id.* at 199. While at first glance it might appear that the manufacturing process begins upon loading the truck, the Court appears to have broken down the manufacturing process into several phases including both the charging phase and the mixing phase. The initial charging phase consists of loading the component parts, in specific proportions, into the turning hollow drum mixer on the ready-mix concrete truck, thus, measuring the proper proportion of the materials is an essential part of the charging process and, therefore, part of the manufacturing process. This determination appears to have been accepted by the Department since purchases of cement batch plants and its parts have been determined to fall within the Manufacturing Machinery and Equipment Exemption in various letter rulings, which although not binding in the case at bar, give some guidance as to the Department’s past interpretation of the law. *See*, Sunshine Letter Nos. 90-0287, 6/11/90; 89-0527, 9/6/89; and 86-0065, 1/23/86.

The Department’s interpretation of the M & E exemption can be discerned by looking to its regulations. Specifically, Section 130.330 (incorporated by Section 150.301(b)) notes that the use of machinery or equipment to store, convey, handle or transport materials or parts or sub-assemblies prior to their entrance into the production cycle will generally not be considered to be manufacturing. 86 Ill. Admin. Code §130.330(d)(4) (*emphasis added*). Nor does the use of machinery or equipment to store, convey, handle or transport finished articles of tangible personal property to be sold or

leased after completion of the production cycle qualify for the exemption. 86 Ill. Admin. Code § 130.330 (d)(4)(C) & (D).

The regulations, however, allow that the following uses among others are considered to be exempt: “use of machinery or equipment to inspect, test or measure the tangible personal property to be sold where such function is an integral part of the production flow; the use of machinery and equipment to convey, handle, or transport the tangible personal property to be sold within production stations on the production line or directly between such production stations or buildings within the same plant; and the use of machinery or equipment to place the tangible personal property to be sold into the container, package or wrapping in which such property is normally sold to the ultimate consumer thereof.” 86 Ill. Admin. Code §130.330(d)(3)(C)-(E).

Pre-production activity is a taxable use under Departmental regulations, however, charging the bins of the concrete batch plant is not pre-production because it is the first step in the series of operations which constitute the manufacture of concrete. Compare this allegedly “pre-production step” to the packaging of the finished good. The Department recognizes that packaging the good is a step in the manufacturing process and, therefore, equipment that serves this purpose is exempt from Use Tax. This is true even though the transformation from raw material into finished good has been completed, i.e., there is no appreciable change in the form of the product for sale in the packaging step, because packaging a product has been determined to be an important link in the production cycle. Likewise, the equipment which charges the bins under the facts and circumstances presented here should be exempt since it is performing a task which constitutes the first link in the whole manufacturing process and is an integral part of the

transformation of raw material into finished good. The use of the front-end loaders in the case at hand can be distinguished from general pre-production activities which would not be so closely linked to this transformation process, such as unloading the railroad cars or moving piles of material at the work site.

The Department established its *prima facie* case by offering the Correction of Returns into evidence, thereby shifting the burden of proof to the taxpayer. *See*, 35 ILCS 105/12. To overcome the *prima facie* case, the taxpayer must produce competent evidence, identified with taxpayer's books and records, showing that the Department's determination is incorrect. A. R. Barnes v. Department of Revenue, 173 Ill. App. 3d (1st Dist. 1988).

Statutes that exempt property or entities from taxation must be strictly construed and doubts regarding their applicability should be resolved in favor of taxation. Van's Material, 131 Ill. 2d at 216. The Department contends that the taxpayer has not met its burden in proving that the front-end loaders were primarily used in the manufacturing process, however, an examination of the record indicates otherwise. For the reasons stated above, I find the front-end loaders initiate the manufacturing process by charging the bins. At hearing the taxpayer produced 18 photographic exhibits depicting the front-end loaders in operation as well as the physical layout of the taxpayer's plant. The photographs prove that its raw materials are delivered by their suppliers' dump trucks and the record reflects that the front-end loaders are not primarily used to unload these trucks or transport material around the work site. The photographic evidence, in conjunction with the credible testimonial evidence which thoroughly explained each phase of the manufacturing process, the role of both front-end loaders in that process and the material

handling capabilities of this equipment shifted the burden back to the Department to prove its contentions by a preponderance of the evidence. Balla v. Department of Revenue, 96 Ill. App. 3d 923 (1981) The record reflects that the Department has not met its burden.

Wherefore, for the reasons stated above, it is my recommendation that the portion of the assessments attributable to the purchases of front-end loaders and its parts should be cancelled. The remaining portion of the assessments should be affirmed as agreed to by the parties and as outlined in Dept. Group Exhibit No. 2.

Date: February 22, 1999

Christine O'Donoghue
Administrative Law Judge